

UNDERSTANDING THE CAPACITY AND NEED TO TAKE ON INVESTMENT WITHIN THE SOCIAL SECTOR SUMMARY REPORT

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Foreword

The UK social investment market is widely recognised as one of the most advanced in the world. The market continues to grow, Big Society Capital estimate that it is now worth over £1.5 billion, spread over 3,500 investments, with a wide range of products. Government continues to support the market and has committed to strengthening the social investment marketplace by ensuring that future programmes make it as easy as possible for charities and social enterprises to access investment appropriate for them.

A range of support is available for charities and social enterprises of all shapes and sizes who consider taking on social investment. The Access Foundation was established in 2015 to make it easier for charities and social enterprises to access the finance they need to grow and increase their impact. Access is delivering its support through funds that offer grants, run support programmes or make small loans to charities and social enterprises. Direct support to charities and social enterprises is also delivered by Big Potential, a BIG Lottery grant fund aiming to improve the sustainability, capacity and scale of organisations to enable them to deliver greater social impact.

We recognise that social investment is not for everyone. For some charities and social enterprises, other forms of finance may be more appropriate, such as grants or philanthropic capital. While only a minority of organisations in the sector have had the chance to explore social investment so far, the figures from the research suggest that there is a significant number of charities and social enterprises that may be able to seek appropriate investment in the future. The report has also highlights, for the first time, the significant scale of active social companies that may be interested in investment to increase their impact. Whilst some of this investment may be made by traditional lenders, social investors can offer valuable support those who are unable to access bank finance or need alternative finance types to complement other funding sources.

The data on assets and liabilities of charities and social enterprises used in this report is a step forward in understanding the true potential scale of the opportunity for social investment. We hope that through making this dataset open, we will encourage researchers, investors, advisers as well as other charities and social enterprises to investigate this data further to help connect them to the appropriate investment they need.

Social Investment Research Council



1. Introduction

In 2015 NCVO was commissioned by the Social Investment Research Council to investigate the experience of social sector organisations engaging with social investment. This is a summary of the project's three strands of work, namely:

- An analysis of the structure and finances of social sector organisations examining the sector's existing financing arrangements and their assets and liabilities
- A literature review on organisations' financing behaviours from research that has already taken place on the UK social investment market
- Case studies on organisations' social investment journeys.

Defining our terms

The definitions of social investment and social sector organisations often vary. We set out below what we mean by the different terms used in this project:

Social investment is defined in line with the definition used by the Social Impact Investment Taskforce as *“investment that intentionally targets specific societal and/or environmental objectives along with a financial return and measures the achievement of both.”*¹

We look at the range of **social sector organisations**, broadly defined as *“Impact-driven organisations with partial or full asset-lock. For example: charities that do not engage in trading; charities and membership groups that trade but do not distribute profits; social and solidarity enterprises; cooperatives; and other profit- or dividend-constrained organisations.”*

This includes the following types of organisations:

- **Registered charities:** Charities registered with the Charity Commission.
- **Charitable foundations and trusts:** General charities whose primary purpose is awarding grants to other voluntary organisations, institutions or individuals.
- **General charities:** Private, non-profit-making bodies serving persons. This excludes sacramental religious bodies or places of worship as well as organisations like independent schools, government-controlled bodies and housing associations. In this publication we use the term 'charities' to refer to general charities. The data analysis in the document is based on this definition.
- **Community organisations:** Organisations that work with a confined local or regional focus. Community organisations may have a legal status or a constitution but there are numerous groups which have neither.

¹ Social Impact Investment Taskforce (2014) *Impact Investment: the invisible heart of markets.*

- **Co-operatives:** An autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.
- **Non-governmental organisations (NGOs):** Organisations working in the fields of global development, social and economic justice and the environment.
- **Not-for-profit sector:** All non-profit organisations including those for private benefit (eg a freehold management company or other body where the benefit is for a defined group), those that are non-commercial (eg housing associations), quangos and other organisations close to government (eg universities).
- **Social enterprises:** Organisations that trade for a social purpose or use their activity to achieve social goals, e.g. co-operatives, community businesses and trading arms of charities.²
- **Social companies:** companies with social goals that do not distribute their profits and use a non-profit legal status. The primary legal forms included are Community Interest Companies, Companies Limited by Guarantee and Registered Societies (formerly known as Industrial and Provident Societies).

2. The data analysis of financial accounts

2.1. Aims of the research

The aim of the research was to produce a detailed and robust analysis of the structure and finances of social sector organisations to help improve understanding of the sector's existing financing arrangements.

2.2. Methodology

Our data on charities is based on NCVO's UK Civil Society Almanac dataset which provides a comprehensive analysis of the finances of registered charities. We focus particularly on a subset of charities based on the "general charities" definition which excludes organisations that are usually covered outside the sector, like independent schools, government-controlled bodies and housing associations. Throughout the document we use the term 'charities' to refer to general charities.

Our research on social companies is more exploratory in nature. We have based the analysis on administrative data from Companies House which lists all registered companies in the UK. The primary legal forms of companies included in the scope of our study are Community Interest Companies (CICs), Charitable Companies Limited by Guarantee (CLGs) and Registered Societies (formerly known as Industrial and Provident Societies). Holding companies and companies which manage or own the freehold of property on behalf of the

² *NCVO Civil Society Almanac NCVO (2014)*

leaseholders were excluded from the analysis. Companies that are also registered charities were excluded to avoid double-counting.

Companies House have opened up a wide range of their data, including the register of companies and the accounts of some companies, which is much more than was previously available freely. This data currently presents some significant gaps, particularly financial information for larger companies and data on registered societies. The analysis of social companies is therefore not as detailed as the analysis of charities.

2.3. Key findings

2.3.1. Charities

- The sector is largely unincorporated. In 2012/13, only 21% of charities are incorporated as companies. However, things are changing: since 2013, when registration of CIOs (Charitable Incorporated Organisations) started, around two-thirds of newly registered charities have incorporation of some sort.
- 160,000 charities have a turnover of £40.5 billion and hold £3.5 billion in loans against a fixed asset base of approximately £64 billion, the majority of which is secured or mortgages.
- Charities' assets are concentrated in a small number of organisations. The top 1% of asset holders (1,168 charities) hold almost three-quarters of these assets (£70 billion).
- Loans make up just 7% of the liabilities of micro and small organisations³ compared to around 41% of the liabilities of medium and large organisations⁴. The subsectors with the largest amount of loans are social services (17% of total loan amounts held by all charities), religion (17%) and grant-making foundations (15%).
- Housing is the subsector with highest average amount of loans outstanding⁵ by £116,000, followed by education (£57,000), infrastructure (£50,000) and religion (£49,000).

Policy and practice implications

At first glance, the research suggests the social sector has significant scope for further borrowing. However, the data highlights a number of challenges:

- The rate of incorporation: most charities are small and many are still unincorporated, meaning that the personal risk to the majority of trustees in taking on debt would likely be considered unacceptable.
- The concentration of assets: three-quarters of all charities own no fixed assets so those that would wish to borrow will require unsecured lending.

³ Organisations with an income of less than £100,000

⁴ Organisations with an income of up to £10 million

⁵ Loans that yet to be repaid

- Revenue growth: many charities would argue that their ability to sustainably increase revenue is constrained by decreases in government funding and flat levels of public donations.
- The size of investments likely to be sought: the highest average loan amount by sector is £116,000 which is considerably lower than the lower bound of loan provision typically available from SIFs at economical interest rates.

A number of areas are likely to offer opportunities for the development of social finance:

- Incorporated charities in the £100,000 to £1 million income range who own tangible fixed assets (likely to be the building they operate in) are likely to be a group with greater potential for investment.
- Based on a number of assumptions, the research suggests that there are 9,300 charities in this group, with a total income of £3.9 billion that are likely to have the greatest demand for secured lending.

2.3.2. Social companies

- There are 67,000 active social companies, with an estimated turnover of at least £16.2 billion.
- CICs are disproportionately common in the North East and North West. CICs and Registered Societies are less likely than CLGs to be located in London.
- The subsectors that have the largest numbers of CICs and CLGs are education, arts and sport, and service activities. In terms of turnover, the two biggest subsectors are education, and health and social care.
- Social companies limited by guarantee have net assets worth £4.4 billion.
- Overall these organisations appear to be generally solvent, with relatively healthy levels of assets compared to liabilities: the average "debt ratio" for these organisations (total liabilities divided by total assets) is around 40%.
- The majority (70%) of companies in our sample have assets in the range of £10,000 to £100,000 and most (60% of them) hold liabilities under £100,000.
- Social companies with mortgages have an average turnover of around £400,000, compared to £85,000 for those without.

Policy and practice implications

This research sets out a new approach to using Companies House data to identify social companies, distinct from charities. While further research would be needed to consider how much investment social companies could sustainably support, this report makes some pertinent findings that would need to be taken into account in any future estimations:

- A majority of social companies' £16 billion turnover is concentrated in larger organisations. To calculate a sustainable level of borrowing for social companies, it

would be sensible to consider a smaller population of larger organisations and the share of turnover that they hold.

- Social companies' liabilities (as measured for CLGs) are largely in proportion to their assets. This measure may indicate a limit to the amount of further liabilities social companies are able to take on, or the type of activity the investment will be taken on for.
- The total average debt ratio of around 40% suggests that as a whole social companies may have an upper sustainable borrowing limit of around twice of what it currently borrows.

The limitations of the data on social companies do not allow us to provide any estimates of lending patterns. In general terms, a similar sectoral profile could be expected for social companies as for charities; many small organisations and a small number of large organisations. As is the case for charities, social companies likely to both want and be able to take on investment will be only a small proportion of all social companies.

2.4. Recommendations

For social investment finance intermediaries (SIFIs) and the investment community as a whole, the findings outlined above should help to better identify organisations that may be in a position to seek social investment. This may enable government and investors to target policy and practical actions, for example to increase supply of smaller loan sizes and shorten application timescales.

The findings are based on new sources of data and methods, but there are still limitations in the data available to analyse these organisations. Two gaps in the data stand out – machine-readable data⁶ on the largest companies and the data available on registered societies.

There is a limit to how much these data can help explain the rate of development of the social investment market. Other external factors are likely to drive demand – particularly the commissioning environment for public services.

However, there are opportunities for some subsectors. With an increase in the volume of assets being sold by local government, this could lead to an increase in borrowing demand where organisations see opportunities to use these assets for service delivery or income generation. Those organisations that are already in a robust financial position will be best placed to take on further liabilities.

⁶ Machine-readable data is data (or metadata) which is in a format that can be understood by a computer

3. The literature review

3.1. Aims of the review

The literature review was carried out to reflect on the state of the evidence base on social investment. The review focuses on the profile and characteristics of those who are accessing social investment; the motivations (financing behaviour and decision-making); and the challenges, barriers and enablers social sector organisations have encountered in engaging with the market.

3.2. Methodology

The review, conducted in 2015, prioritised the most recent literature on the UK marketplace available at the time. We reviewed 25 published reports alongside a variety of online materials, resources and blogs. Our sample includes academic research, data syntheses and compendiums, national strategy documents, reports of surveys, and discussion papers and think pieces.

3.3. The evidence base

Despite a growing and increasingly “voluminous” body of research on social investment⁷, there remain a number of important gaps in the evidence base. As well as evidence gaps, there are large areas where evidence (or interpretations of it) is conflicting, leaving us with more points of disagreement than consensus about how, and how well, social investment is working in practice both for investors and for investees. Our review identified three main sources of confusion:

- **Definitions and data.** A lack of shared definitions and a lack of completeness, consistency and transparency with regards to data collection and reporting about investments and investees has contributed to a lack of clarity about market activity and growth.
- **Conflating investment levels with engagement levels.** We know a relatively small number of large organisations have benefited from some very large investments. Referencing only the total amount invested in such circumstances has the potential to mislead about the scale of sector engagement and may have contributed to over-estimates of engagement.
- **Enthusiasm for the idea of social investment.** Some of social investment’s most engaged champions and advocates, people with a genuine enthusiasm for social investment, may have been over-represented as contributors to the body of research as it has emerged so far and their enthusiasm may have played a part in what has

⁷ *Social Spider CIC (2015) p5*

recently been called “forecast optimism”, generating an over-optimistic view of the time needed to grow the market and to increase the sustainability or impact of social sector organisations through new and different types of investment.⁸

3.4. Sector engagement

The evidence suggests that a majority of social sector organisations considering or actively seeking to attract social investment continue to be larger organisations, and that there is a strong correlation with not only size but also asset ownership, and attitudes towards investment and risk within the organisation’s leadership team or governing body. However, motivations for seeking investment are mixed and issues of timing and the availability of relevant opportunities are also important factors.

The most common motivations for seeking investment are still to invest in assets and growth/scaling up, including to win larger contracts. However, because of the way the marketplace has been developed, the pattern of motivations and take-up of investment may be as much shaped by supply as by what organisations most need and there is some evidence that, particularly in what are difficult financial times for the sector, consolidation and adapting may be equally important drivers.

A relatively high proportion of the sector remain uninterested in social investment and repayable finance more generally, simply not seeing it as an option for them. The evidence suggests that explanatory factors include a lack of awareness/understanding and a lack of confidence in how to engage. In addition organisations are concerned about the level of risk and lack of capacity to generate income to repay debt. Others consider it a poor fit with charitable values or views on income generation, or a poor fit with the type of services and/or social outcomes the organisation delivers.

There is broad consensus that the market could operate more effectively for those who are interested in social investment, and that it could be easier for social sector organisations to engage. Despite differing views on what to prioritise to improve things, the three most commonly identified solutions are: addressing mismatches between supply and demand; continuing to offer investment readiness support; and finding ways to reduce the costs of investment and the complexity of investment processes.

3.5. Measuring success

Much of the research that has been conducted to date focuses on the effectiveness of social investment as a funding mechanism rather than as “a tool to help increase social impact”.⁹ It may be timely now for future research to look at questions of impact alongside questions of effectiveness, that is, to address fundamental questions about what difference social investment is making.

⁸ Huckfield (2014)

⁹ HM Government (2014) p6

4. The case studies

4.1. Aims of the case studies

The case studies aimed to capture organisations' stories about accessing support and investment and to share the realities of the organisations' social investment journeys.

4.2. Methodology

We sought to tell the stories of organisations that were different in size and type, had different motivations for seeking support or investment, and have achieved varying degrees of success in accessing the support or financing they feel they need. **Whilst we cannot claim that the case studies are representative of the whole sector, they illustrate some of the key themes that emerged in our review of the available data and the published literature.**

4.3. TwentyTwenty

TwentyTwenty is a medium-sized charity that has achieved mixed success in its engagement with social investment so far. Reflecting on its experiences, the organisation has felt at times it is negotiating its way along a path that can feel like it was designed with larger organisations in mind. Being neither a start-up enterprise, nor a large charity with either a large turnover or an asset-base, TwentyTwenty is one of many organisations that can potentially feel they are falling through the net of the provision currently available. However, despite the challenges they have faced, the organisation remains appreciative that this path exists, and optimistic that when the time and circumstances are right, social investment could still help them deliver on their plans to build up their services and increase their social impact. Their Chief Executive, Mike Hughes, talked to us about TwentyTwenty and their experiences.

4.4. Nova

Nova is a relatively newly established voluntary sector infrastructure organisation created from the merger of two local organisations in 2013. Prior to the merger, Nova, then known as Wakefield District Wellbeing Consortium (WDWC), received a mixed loan/grant start-up investment in 2011-12 that made all the difference in a challenging first year of operation. Looking back now following a period of growth and change, of which their merger was just a part, Nova recognises how valuable this financing was to them, and more generally the importance of having investors out there willing to take a risk on new ventures and able to offer small to medium-sized investments. Alison Haskins, CEO at Nova (and WDWC before that) shares her reflections on how repayable finance helped her organisation get started. As the leader of a membership organisation she also shares her concern that many of the business models emerging under the social investment umbrella will prove unworkable for large parts of the sector because of the type and scale of their operations.

4.5. Fair for You

Fair for You is a new social business that has struggled to attract social investment. The team has developed a strong business case; with the clear potential to create social impact and a financial return on investment; and growing support for its vision and ideas from practitioners and policy-makers with an interest in anti-poverty initiatives. With the additional benefit of a CEO with a background in the financial sector, and a strong team with relevant experience, on paper Fair for You might seem an ideal candidate for social investment. The reality has been different, and the lead team have found support, intermediaries and investors difficult to negotiate, and relatively risk-averse and with little time to be able to consider a new concept. Their story reflects some of the commonest criticisms made of how the market is experienced by potential investees and acts as a reminder that despite high profile success stories this is a marketplace in development with a distance yet to travel to match supply with demand.

4.6. Depaul UK

Depaul UK is one of the UK's leading providers of housing and support for homeless and vulnerable young people. It is a social investment "success story", benefiting from investment-readiness support and recently a contract worth more than £1m through the Fair Chance Programme (a Social Investment Bond). Though it is relatively early days, the Fair Chance funding is enabling Depaul to significantly develop its floating support provision targeting the most socially excluded young people. The 'Fair Chance' Programme Manager at Depaul, Simone Newman, works closely with the organisation's new social investors, and reflects here on some of her own and her colleagues' learning about this new approach to funding their work; the tensions inherent in a payment by results approach to a service for disadvantaged and often disengaged young people; and some of the challenges but also the unexpected benefits of social investment so far.

4.7. Key reflections

The following reflections are the ones that emerged most strongly from our conversations with our four contributors.

- Support to make better decisions is crucial – a better-informed decision can be as important an outcome as attracting an investment.
- The market can appear Darwinian in its operation, favouring the large and the already strong over smaller and newer ventures.
- "Is it worth it?" can be as important question to ask as "can we do it?" when pursuing social investment.
- Having a pool of investors and programmes willing to take risks with start-ups, new ventures and to offer smaller funding options is vital.

- When starting out with social investment, having the right kind of support is key - including knowledgeable individuals who can help you negotiate and understand your options and possibilities.
- Though more could be done to make repayable finance more accessible, the reality is that other sources of funding remain incredibly important for the bulk of the sector for whom social investment business models simply won't fit.
- The process of achieving investment at scale takes time and is more complex than other more familiar routes.
- Working differently is likely to be required for some forms of social investment financing, and this could create the need for cultural as well as systems change.
- A genuinely outcomes-focused approach does have the potential to generate more flexibility and creativity – allowing different routes and the identification of the best route to achieving results.
- The marketplace remains complicated, hard to understand and negotiate and can feel very 'user-unfriendly' for many. It may thus be in danger of missing out on investing in precisely the kinds of initiatives that could most make a difference.
- It would be good if research was done to 'follow the money', to look at what has been funded, and the balance of money flowing to intermediaries compared to what reaches organisations who create social impact.